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Docket No. MC96-3

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

DIRECT TESTIMONY

OF

PAMELA A. THOMPSON

ON BEHALF OF

THE OFFICE OF THE CONSUMER ADVOCATE

SEPTEMBER 30, 1996

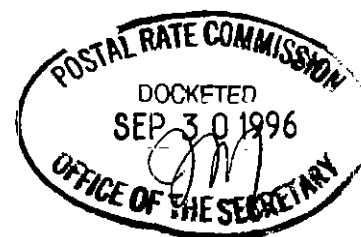


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1 DIRECT TESTIMONY OF

2 PAMELA A. THOMPSON

3 STATEMENT OF QUALIFICATIONS

4

5 My name is Pamela A. Thompson. I am a Postal Rate and
6 Classification Specialist for the Office of the Consumer
7 Advocate (OCA). I have been employed at the Postal Rate
8 Commission since March 1990. I have testified previously
9 before this Commission in Docket Nos. R90-1, MC93-1, R94-1 and
10 MC95-1. My testimony in Docket No. MC95-1 proposed a Courtesy
11 Envelope Mail (CEM) rate category and a 12 cent per piece
12 discount for qualifying First-Class single-piece courtesy
13 reply envelopes. My testimony in Docket No. R94-1 proposed a
14 new methodology for the recovery of prior years' losses. I
15 also proposed a change in the amount of, and the allocation
16 methodology for, a contingency provision. In Docket No.
17 MC93-1, my testimony reviewed the Postal Service's cost
18 coverage for the new BSPS classification proposal. In Docket
19 No. R90-1, my testimony proposed the adoption of two
20 discounted single-piece rate categories within First-Class
21 Mail. A three-cent discount was proposed for Courtesy
22 Envelope Mail (CEM), an automation-compatible prebarcoded

1 envelope. The second category, Automation Compatible Envelope
2 (ACE), consisted of mail pieces to be produced and sold by the
3 Postal Service as a specialized form of the stamped envelope
4 products currently offered by the Postal Service.

5 Prior to my employment with the Postal Rate Commission, I
6 was an Assistant Controller for Chemical Waste Management
7 (CWM). My responsibilities included management of a regional
8 accounts payable department and reviewing and reporting the
9 financial performance of a midwestern division of the company.

10 Prior to my employment with CWM, I was a Staff Business
11 Planner for a division of International Business Machines
12 (IBM). At IBM, I worked principally in the areas of strategic
13 planning, pricing and implementation.

14 I received my MBA from Wright State University in Dayton,
15 Ohio, in 1979. I received a BA in 1975 from the Christopher
16 Newport College of the College of William and Mary. I have
17 taken additional computer science courses from the University
18 of Colorado.

1 I. PURPOSE AND SCOPE OF TESTIMONY

2 The purpose of this testimony is to show that the Postal
3 Service is proposing to misuse the classification reform
4 framework to target a few special services for price
5 increases. Other than insuring that targeted special services
6 cover their costs, the Postal Service has not justified its
7 request for additional net revenues.

1 II. THE POSTAL SERVICE IMPROPERLY PROPOSES TO ABANDON REVENUE
2 NEUTRALITY IN ITS CLASSIFICATION REFORM EFFORTS AND
3 UNFAIRLY AND INEQUITABLY TO TARGET SELECTED SPECIAL
4 SERVICES FOR RATE INCREASES
5

6 The Postal Service's phased approach to classification
7 reform has allowed interested parties to focus on specific
8 issues. Since both Docket Nos. MC95-1 and MC96-2 were net
9 revenue neutral, the Postal Service was able to focus the
10 classification reform initiatives on structural changes while
11 limiting debates on inter-class cost coverages.¹

12 Prior to Docket No. MC96-3, the proposed rates for the
13 reformed subclasses were designed to provide the same test
14 year contribution to institutional costs as was projected by
15 the Commission in Docket No. R94-1.² Classification reform
16 was not intended to generate new revenues

17 nor [be] an opportunity to challenge, change, or
18 improve on the Commission's conclusions drawn from
19 the record in Docket No. R94-1. . . . [T]he Postal
20 Service is not seeking to increase or decrease

¹ Docket No. MC96-2, Request of the United States Postal Service for a Recommended Decision on Further Classification Reform of Preferred Rate Standard Mail and Periodicals at 5.

² Id.

1 institutional cost contributions beyond the levels
2 recommended by the Commission and approved by the
3 Governors in Docket No. R94-1.³

4
5 In April 1996, the Postal Service filed Docket No.

6 MC96-2, the second classification reform initiative⁴ and asked
7 the Commission to follow the same principles and methodologies
8 espoused in Docket No. MC95-1.⁵ Two months after filing its
9 Docket No. MC96-2 Request, the Postal Service filed the third
10 classification reform initiative, Docket No. MC96-3. Docket
11 No. MC96-3 abandons the earlier classification reform goal of
12 net revenue neutrality.⁶ The Postal Service acknowledges the
13 change in philosophy:

14 This filing is unusual in that it would have
15 the effect of increasing net revenue for the Postal
16 Service, outside of an omnibus rate proceeding.⁷

³ Id. at 4-5.

⁴ Docket No. MC96-1 was a request for an experimental automation rate category and is not considered a classification reform initiative for purposes of my testimony.

⁵ Docket No. MC96-2, Request of the United States Postal Service for a Recommended Decision on Further Classification Reform of Preferred Rate Standard Mail and Periodicals at 3.

⁶ For further discussion of changes in classification reform philosophy, see also Tr. 2/160-61, 215-16, and 221-23.

⁷ Docket No. MC96-3, Request of the United States Postal Service for a Recommended Decision on Special Service Changes at 3.

1 The departure from the earlier philosophy is due in part
2 to a new policy of the Board Of Governors to restore equity;
3 revenues of \$339.4 million are purportedly needed to help
4 achieve this goal.⁸ The Postal Service admits, as does
5 witness Lyons, that the Postal Service's negative equity
6 position was not caused by any one class or subclass of mail.⁹
7 It certainly was not caused by the special services targeted
8 for rate increases by the Service. Therefore, it is unfair
9 and inequitable to depart from the earlier classification
10 reform policy of net revenue neutrality by burdening special
11 services alone with additional non-attributable net revenue
12 requirements.

⁸ USPS-T-1 at 6-9.

⁹ Tr. 2/146-148.

1 III. THE POSTAL SERVICE'S RATIONALE FOR REQUESTING ADDITIONAL
2 NET REVENUES IS FATALLY FLAWED
3

4 The Docket No. MC96-3 classification reform initiative
5 includes a net revenue request of \$339.4 million, ostensibly
6 based upon two Postal Service objectives. One objective is
7 established by Board of Governors Resolution No. 95-9, which
8 calls for equity restoration, and the other is the achievement
9 of general Postal Service financial goals.¹⁰
10

11 A. The Equity Restoration Objective Is Being Attained
12 Without a Rate Increase
13

14 Board of Governors Resolution No. 95-9 states that the
15 Postal Service shall plan for
16 cumulative net income, in the period since
17 implementation of the rates adopted in the most
18 recent omnibus rate proceeding, to equal or exceed
19 the cumulative prior years' loss recovery target for
20 the same period.¹¹

¹⁰ USPS-T-1 at 6.

¹¹ USPS-LR-SSR-112 (emphasis in the original).

1 Board of Governors Resolution No. 95-9 directs the Postal
2 Service to restore equity through recovery of prior years'
3 loss (RPYL). A comparison of the RPYL provision established
4 by the Commission in Docket No. R94-1 and the Postal Service's
5 net income for fiscal year (FY) 1995 demonstrates that the
6 RPYL provisions for FY 95 and FY 96 are fully funded.¹²

7 Postmaster General Runyon has stated,

8 Nationwide, we are squarely on track to finish the
9 year with another billion dollar-plus net income.
10 That would be the Postal Service's second highest
11 net income in history, second only to last year's
12 record \$1.8 billion.¹³

13 To date, the Postal Service estimates its FY 96 net income to
14 be between \$1.2 and \$1.5 billion.¹⁴ Consequently, the sum of

¹² Docket No. R94-1 was the most recent omnibus rate proceeding. The Commission provided for annual RPYL in the amount of \$936.2 million. PRC Op. R94-1, para. 2071. The 1995 Annual Report of the Postmaster General at 41, indicates that net income was \$1.8 billion. The Postal Service's FY 95 net income provided sufficient funding for the RPYL provision for FY 95 and \$834 million towards FY 96 requirements (See OCA/USPS-74).

¹³ Remarks by Postmaster General Marvin Runyon at the Monthly Meeting of the Postal Service Board of Governors, Detroit, Michigan, August 6, 1996.

¹⁴ Transcript of Proceedings of Board of Governors Meeting, September 10, 1996, at 17.

1 FY 95 and FY 96 net revenues is sufficient to fund fully the
2 RPYL provision through FY 97 and into FY 98.¹⁵ The Postal
3 Service's financial performance, has fully satisfied, and even
4 exceeded, the Board of Governors' policy objective of equity
5 restoration. Michael J. Riley, Chief Financial Officer of the
6 Postal Service, has stated,

7 The budgeted income [for FY 97] is a positive
8 \$55 million. It meets Management's goals, and it
9 exceeds the requirements of the Board's prior year
10 loss recovery policy by a positive \$648
11 million. . . .

12 Based on the estimated \$1.2 billion surplus
13 projected for Fiscal '96, we will have continued the
14 reduction of cumulative losses. The \$55 million net
15 income budgeted for '97 continues to reduce the
16 cumulative losses and keeps us about \$700 million
17 ahead of the Board Resolution 95-9 through the end
18 of Fiscal '97.¹⁶

19 Claiming that special service fee increases are needed to meet
20 the Board of Governors Resolution No. 95-9 policy objective is
21 obviously baseless.

¹⁵ See OCA/USPS-74.

¹⁶ Transcript of Proceedings of Board of Governors
Meeting, September 10, 1996, at 18-19.

1 B. The Postal Service's General Financial Policy Goals Fail
2 To Justify Increased Net Revenue
3

4 Postal Service witness Lyons identifies general financial
5 policy goals as a primary reason for requesting additional net
6 revenues. The financial policy goals mentioned in his
7 testimony are controlling costs, generating sales, maintaining
8 current rates and fees (with the exception of those targeted
9 in Docket No. MC96-3) for longer periods of time, moderating
10 the magnitude of a future rate increase, and seeking demand-
11 oriented price adjustments previously deferred.¹⁷ Though cost
12 containment and increased sales volume affect net income,
13 these worthy goals can be accomplished without raising rates,
14 and my testimony does not address them.

15 1. "Stable" Rates Should Not Be Obtained by Means Of
16 Unfair and Inequitable Ratemaking
17

18 In March 1996, Postmaster General Runyon stated,

19 The officers have committed to a stringent program
20 to turn our projected loss for next year [1997] into
21 a \$100 million net income. This will allow us to
22 keep rates stable through 1997. . . . Our long-term

¹⁷ USPS-T-1 at 3 and 6.

1 goal is to keep prices where they are as long as
2 possible¹⁸

3
4 The August 30, 1996, AMMA bulletin states that Postmaster
5 General Runyon does not foresee a rate increase before 1998
6 and possibly beyond. During oral cross-examination, Postal
7 Service witness Lyons stated,

8 the rates we have right now, . . . are going to be
9 in effect the Postmaster General said at least
10 through 1998.¹⁹

11 If the Postal Service's current request for additional net
12 revenues is approved, then some rates will necessarily change.
13 Therefore, there will be no rate stability for those special
14 services subject to Docket No. MC96-3 rate increases. Postal
15 Service witness Lyons resolves confusion over what constitutes
16 stable rates by identifying basic First-Class rates as the
17 determinant.²⁰ Since this docket does not impact First-Class
18 rates, witness Lyons says that increasing rates for select

¹⁸ Testimony Scheduled for Delivery by Postmaster General Marvin Runyon Before the House Appropriations Subcommittee on Treasury, Postal Service, and General Government, Washington, DC, March 27, 1996.

¹⁹ Tr. 2/149.

²⁰ Tr. 2/175.

1 special services is consistent with the stable rate objective.
2 However, sparing all other subclasses and services rate
3 increases at the expense of a few, select, special services is
4 unfair and inequitable. Approval of the Postal Service's
5 Docket No. MC96-3 request for increased net revenues fosters a
6 selective pricing philosophy. Selectively burdening classes
7 or subclasses of mail with non-attributable net income
8 requirements violates the principles of fairness and equity
9 under 39 U.S.C. § 3622(b)(1) and § 3623(c)(1). The choice of
10 a few special services as the source of additional revenue was
11 entirely coincidental and thus capricious.

12

13 2. Moderating Future Rate Increases for Most Classes
14 Should Be Accomplished in an Omnibus Rate Case and
15 Does Not Justify Selective Price Increases
16

17 Filing an omnibus rate case does not automatically result
18 in significant rate increases. If the Postal Service were to
19 file an omnibus rate request that sought additional net
20 revenues of \$339.4 million, average rate increases would be
21 minimal. For example, if the First-Class mailstream alone had
22 to provide \$339.4 million in additional net revenues, the

1 average rate increase would be only \$0.003 per piece
2 (rounded). (If revenues of \$339.9 are needed then \$339.9
3 million / 98,201.390 million = \$0.003. See also USPS-T-1 at
4 8.)²¹ If all classes and services were burdened with providing
5 the \$339.4 million, the average impact on postal rates would
6 be minuscule. Even if First-Class letters were excluded from
7 a general rate increase (as seems to be the policy expressed
8 by witness Lyons), the increase for all other subclasses would
9 average \$0.004 per piece (rounded).²² Restricting the net
10 revenue request to select special services, on the other hand,
11 causes some special service fee increases to be very large.
12 Therefore, the Postal Service's strategy for increasing net
13 revenues is unfair and unrelated to any legitimate financial
14 goal.

²¹ USPS-T-1, WP E at 1. If First-Class non-presort letter volumes were tasked with providing \$339.4 million, the average rate increase would be \$0.006189 (\$339.4 million / 54,841.077 million pieces).

²² $\$339.4 / (184,625.794 - 54,841.077 - 34,984.069 - 3,199.666)$. Volumes from USPS-T-1 WP E at 1-2.

1 3. Seeking Price Adjustments Previously Deferred Does
2 Not Justify Selective Rate Increases

3
4 During Docket No. R94-1 proceedings, interested parties
5 reviewed and debated all the data and information available,
6 and all factors of the Postal Reorganization Act (Act) were
7 considered when rates and fees were established.

8 Postal Service witness Lyons testifies that demand-
9 oriented price adjustments previously deferred should now be
10 addressed.²³ The Postal Service chose to defer the pricing
11 adjustments. Isolating one class or subclass of mail for
12 unfavorable treatment is discriminatory and deprives these
13 mailers of the fairness and equity due them. Approval of the
14 Postal Service's current request for selective and unjustified
15 price adjustments for the purpose of increasing net revenues
16 encourages similar future filings whose purpose is divide-and-
17 conquer ratemaking.

²³ USPS-T-1 at 6.

1 IV. RATE INCREASES SHOULD BE LIMITED TO THOSE CLASSES OR
2 SUBCLASSES OF MAIL FAILING TO COVER THEIR COSTS
3

4 Resource constraints may cause the Postal Service to
5 defer an omnibus rate request while classification reform
6 initiatives are being pursued. Changes such as cost increases
7 and volume shifts can result in classes and subclasses of mail
8 having insufficient revenues to cover costs. If a
9 classification initiative is filed and the revenues generated
10 by the class or subclass of mail undergoing reform fail to
11 cover costs, then rate increases may be appropriate. The rate
12 increases should be designed to be contribution neutral.
13 Otherwise, favored classes and subclasses of mail (or even
14 individual mailers) may experience infrequent rate increases,
15 while less favored classes and subclasses of mail could be
16 subject to frequent rate increases. Rate increases for the
17 purpose of increasing net revenues should be fairly allocated
18 to all classes and services in an omnibus rate proceeding.

1 V. CONCLUSION

2 The Postal Service has not shown any need for increased
3 net revenues. This classification reform initiative unjustly
4 selects special services to bear the brunt of an apparently
5 ever-escalating revenue requirement. Accepting the Postal
6 Service's pricing proposal encourages future "classification"
7 reform initiatives to incorporate new net revenue requirements
8 so that politically unpleasant general rate increases
9 affecting powerful special interests can be deferred
10 indefinitely. By means of selective price increases, the
11 Postal Service will be able to target some classes or
12 subclasses of mail for unfair and inequitable treatment, while
13 shielding other classes from such effects.

14